[JOINT COMMITTEE PRINT]

FEDERAL TAX TREATMENT OF INDIVIDUALS BELOW THE POVERTY LEVEL

SCHEDULE FOR A HEARING

BEFORE THE

SENATE COMMITTEE ON FINANCE

ON JUNE 17, 1985

PREPARED BY THE STAFF

OF THE

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INTRODUCTION

The Senate Committee on Finance has scheduled a public hearing on June 17, 1985, relating to the Federal tax treatment of individuals with income below the poverty level.

The first part of the pamphlet [1] compares the level of income below which a family is considered to live in poverty (the "poverty level") with the level of income at which a family begins to pay Federal income tax (the "tax threshold"). The second part describes provisions of present law affecting the tax threshold. The third part discusses the amount of Federal income tax payable, under present law, by individuals at the poverty level. The fourth part describes issues involved in proposals to alleviate Federal income tax burdens on low-income individuals. The final part summarizes certain provisions of the Administration's recent tax reform proposal and of Senate bills introduced to date in the 99th Congress intended to accomplish that objective.

[1] This pamphlet may be cited as follows: Joint Committee on Taxation, *Federal Tax Treatment of Individuals Below the Poverty Level* (JCS-18-85), June 14, 1985.

I. COMPARISON BETWEEN POVERTY LEVEL AND INCOME TAX THRESHOLD

During the 1960's and 1970's, the Congress sought to eliminate any Federal income tax liability for families whose income was below the poverty level. The amount of income considered to mark the poverty level has been computed annually by the Federal Government since the 1960's. On the basis of data indicating that nonfarm families generally spend about one-third of their income for food, the poverty level originally was computed as three times the amount of money necessary to purchase the lowest cost "nutritionally adequate" diet calculated by the Department of Agriculture, with adjustments such as for family size and for farm families. The poverty level is now established simply by increasing the prior year's level by the change in the Consumer Price Index.

Several approaches were used in tax legislation enacted in 1969, 1975, 1976, 1977, and 1978 in seeking to increase the level of income at which a family begins to pay Federal income tax (termed the tax threshold or entry point) to a point at or above the poverty level. These approaches included increases in the personal exemption, increases in the standard deduction (now termed the zero bracket amount), and enactment of and increases in the earned income tax credit. In recent years, however, these provisions have not kept pace with inflation, and as a result, the income tax threshold has fallen well below the poverty level.

Table 1 below compares the poverty level and the Federal income tax threshold for a family of four for selected years between 1960 and 1988 (as estimated under present law). The tax computations in the table reflect assumptions that all family income consists of wages or salaries, that families of two or more include a married couple (rather than an unmarried head of household with one or more dependents), that all family members are under age 65, and that families of three or more persons are eligible for the earned income credit.

In 1960, the poverty level for a family of four was $3,022, but Federal income tax had to be paid on earnings above $2,667; this tax threshold was 11.7 percent below the poverty level. As a result of the 1964 tax cuts, this gap was narrowed to 6.9 percent by 1965. However, as a result of inflation by 1969, the tax threshold ($3,000) fell to 19.9 percent below the poverty level ($3,743). The Congress responded by enacting tax reductions in 1969 and 1971 which succeeded in eliminating the gap in 1972; i.e., no income tax was due unless earnings were greater than the poverty level amount.

The rapid inflation of 1973-74 caused the gap to reemerge for those years. Accordingly, in 1975 the tax cuts were so structured that the income tax threshold for a family of four ($6,692) was 21.7 percent above the poverty level ($5,500). The earned income tax credit, enacted that year, was designed not only to remove low-

income individuals from the income tax rolls but also, because the credit is refundable, to offset some of the impact of the social security payroll tax on their earnings.

However, as a result of inflation in subsequent years, the tax threshold dropped to 11.5 percent below the poverty level in 1982, 13.6 percent below in 1983, and 17.2 percent below in 1984. It is estimated that in 1987 and 1988, the gap (under present law provisions) will increase to 18.8 percent and 20.7 percent, respectively, the largest gap since before 1960. For 1986, it is estimated that the poverty level for a family of four will be $11,502, but (under present law) the family will have to pay income tax beginning at $9,573. This shortfall is estimated to continue to grow for some families notwithstanding the impact of indexing of personal exemptions and the zero bracket amount, which took effect in 1985, since the earned income credit is not indexed.

Table 1.—Relationship Between Poverty Level and Income Tax Threshold for a Family of Four, 1960–1988

Year	Poverty level (family of four)	Income tax threshold	Percentage by which tax threshold falls below (exceeds) poverty level
1960	$3,022	$2,667	11.7
1965	3,223	3,000	6.9
1966	3,317	3,000	9.6
1968	3,553	3,000	15.6
1969	3,743	3,000	19.9
1970	3,968	3,600	9.3
1971	4,137	3,750	9.4
1972	4,275	4,300	(0.6)
1973	4,540	4,300	5.3
1974	5,038	4,300	14.6
1975	5,500	6,692	(21.7)
1976	5,815	6,892	(18.5)
1977	6,191	7,533	(22.0)
1978	6,662	7,533	(13.1)
1979	7,412	8,626	(16.4)
1980	8,414	8,626	(2.5)
1981	9,287	8,634	7.0
1982	9,862	8,727	11.5
1983	10,178	8,783	13.7
1984	[1] 10,612	8,783	[1] 17.2
1985	[1] 11,003	9,437	[1] 14.2
1986 (present law)	[1] 11,502	[1] 9,573	[1] 16.8
1987 (present law)	[1] 11,990	[1] 9,739	[1] 18.8
1988 (present law)	[1] 12,491	[1] 9,909	[1] 20.7

[1] Estimated. The table reflects assumptions that all family income consists of wages or salaries, that families of two or more include a married couple (rather than an unmarried head of household with one or more dependents), that all family members are under age 65, and that families of three or more persons are eligible for the earned income credit.

II. CODE PROVISIONS AFFECTING INCOME TAX THRESHOLD AND LOW-INCOME INDIVIDUALS

The principal provisions of the Internal Revenue Code that have determined the Federal income tax threshold over the last 20 years are listed in Table 3 below. These are the personal exemption and minimum standard deduction (now the zero bracket amount), both of which have been in the law for many years, and the earned income tax credit, enacted in 1975. (In addition, the general tax credit that was in effect between 1975 and 1978 affected the tax entry point in those years.) The child care credit and the credit for the elderly and disabled only affect taxpayers eligible for those credits.

Personal exemption

The personal exemption, which is subtracted as the final step in computing taxable income, is the principal tax law provision that differentiates tax burden by family size.

Each individual is entitled to one personal exemption (one for a single return and two for a joint return), and an additional exemption is allowed for each person who qualifies as a dependent of the taxpayer. (An unmarried head of household, like other unmarried individuals or a married person filing separately, has one exemption; however, the tax rates applicable to a head of household are lower than the rates for single persons or married persons filing separately.) Further, an extra exemption is allowed for a taxpayer age 65 or over, and for a taxpayer who is blind.

The personal exemption remained at $600 between 1948 and 1969, after which it was increased in stages to $750 for 1972-78. The Revenue Act of 1978 increased the exemption further to $1,000. Beginning in 1985, the personal exemption is indexed for inflation ($1,040 for 1985).

The present $1,040 exemption is much smaller, when adjusted for inflation, than was the $600 exemption in 1948; that is, the exemption today would have to be $2,614 to be equivalent in dollar terms to the $600 exemption in 1948. Also, the exemption has not kept pace with inflation since 1964; i.e., $600 in 1964 would be worth $2,009 in 1985. As a result of the erosion of the real value of the exemption, the extent to which the tax burden on large families is lower than the tax burden on small families at the same income level has gradually lessened. As a result, the current gap between the poverty level and the tax threshold is greater for large families than for small families.

Zero bracket amount (standard deduction)

The zero bracket amount (ZBA) originated as a standard deduction, designed to give taxpayers an alternative to itemizing their personal deductions. Prior to 1964, the standard deduction equaled

10 percent of adjusted gross income (subject to a maximum) and was subtracted by nonitemizers in computing taxable income.

Starting in 1964, the Congress began to target the standard deduction toward lower-income taxpayers. That year, the minimum standard deduction (also called the low-income allowance) was enacted and equaled $200 plus $100 for each personal exemption (i.e., $600 for a married couple with two children). In 1969, the minimum standard deduction was increased to $1,100 for 1970 and $1,050 for 1971. The 1971 and 1975 tax cut legislation increased the minimum standard deduction for joint returns to $1,300 and $1,900, respectively. Also, in 1975 the minimum standard deduction was established at a lower level for single returns ($1,600) than for joint returns ($1,900).

In 1977, the standard deduction was set at a flat amount for all taxpayers ($2,200 for single returns, $3,200 for joint returns, and $1,600 for married persons filing separate returns), built into the tax schedules as a tax bracket with a zero rate, and renamed the zero bracket amount (ZBA). Thus, the standard deduction amount is no longer actually deducted by the taxpayer in computing taxable income; instead, the taxpayer pays a zero tax on the amount of taxable income up to the ZBA. Itemizers must subtract their ZBA from their itemized deductions in order to avoid doubling the benefit of the ZBA.

For 1979-84, the ZBA was $2,300 for single returns and $3,400 for joint returns ($1,700 for married persons filing separate returns). Beginning in 1985, these amounts are indexed for inflation. The 1985 ZBA is $2,390 for single returns and $3,540 for joint returns ($1,770 for married persons filing separate returns). An unmarried head of household has the same ZBA as other unmarried individuals or a married person filing separately; however, the tax rates applicable to a head of household are lower than the rates for single persons or married persons filing separately.

For individuals who are not eligible for the earned income credit, the personal exemption and the zero bracket amount determine the tax entry point. Thus, for such a single taxpayer, the tax entry point for 1985 is $3,430 ($1,040 exemption plus $2,390 ZBA). For such a married couple, it is $5,620 ($2,080 exemption plus $3,540 ZBA). For such a married couple with two children, the tax entry point is $7,700 ($4,160 exemption plus $3,540 ZBA).

Earned income tax credit

The earned income tax credit was enacted in 1975 as a means of targeting tax relief to working low-income taxpayers with children, providing relief from the payroll tax for these taxpayers, and improving work incentives. (The credit is only available to a taxpayer living with his or her dependent child.) Unlike other tax credits, the earned income credit is refundable; i.e., the amount of the credit is paid to the taxpayer to the extent it exceeds tax liability. Also, under an advance payment system, eligible individuals may receive the credit with their paychecks, rather than waiting to claim a refund on their return filed for the year.

As originally enacted, the credit equaled 10 percent of the first $4,000 of earned income (i.e., a maximum credit of $400) and was phased out for adjusted gross income of $4,000 to $8,000. For 1979-

84, the maximum credit was increased to $500 (10 percent of the first $5,000 of earned income), and the phaseout was raised to income levels of $6,000 to $10,000.

Under the Deficit Reduction Act of 1984, the earned income credit was increased (beginning in 1985) to 11 percent of the first $5,000 of earned income, for a maximum of $550. The credit is now phased out for adjusted gross income of $6,500 to $11,000. Unlike the personal exemption and the zero bracket amount, the dollar limitations determining the amount of the earned income credit are not indexed for inflation.

The tax thresholds shown in Table 1 above include the impact of the earned income credit for years after 1974. Thus, for a four-person family for 1983, the tax entry point ($8,783) is the income level at which the tax before credits exactly equals the allowable earned income credit.

Table 2 below shows the total amount of earned income credits received for each of the calendar years since the inception of the program, the number of recipient families, the amount of the credits received as Treasury checks, and the average amount of the credit received per family. For 1983, approximately 45 percent of credit recipients were married couples filing joint returns and 55 percent were unmarried head of household returns.

Table 2.—Data Concerning Earned Income Credit, 1975–1986

Calendar year to which credit applies	Total amount of credit (in millions)	Number of families who received credit (in thousands)	Refunded portion of credit (in million [1]	Average credit per family
1975	$1,250	6,215	$900	$201
1976	1,295	6,473	890	200
1977	1,127	5,627	880	200
1978	1,048	5,192	801	202
1979	2,052	7,135	1,395	288
1980	1,986	6,954	1,370	286
1981	1,912	6,717	1,278	285
1982	1,775	6,395	1,222	278
1983 [2]	1,786	6,250	1,287	286
1984 [3]	1,643	NA	1,183	NA
1985 [3]	1,947	NA	1,460	NA
1986 [3]	1,791	NA	1,343	NA

[1] This is the portion of the credit that exceeds tax liability; it is treated as a budget outlay. All these credits were paid in the following year until 1979, when advance payments of the credit were permitted, by addition to the worker's paycheck.

[2] Preliminary.

[3] Estimated (under present law).

NA—Not available.

General tax credit (1975–1978)

Between 1975 and 1978, the Congress adopted a temporary general tax credit as an additional means of providing tax relief to lower-income persons. As enacted in 1975, the credit was $30 for each personal exemption. In 1977, it was increased to the greater of $35 per exemption or two percent of the first $9,000 of taxable income. The 1978 tax reduction legislation eliminated the general tax credit, replacing it with an increase in the personal exemption. Unlike the earned income credit, the general tax credit was not refundable.

Child care credit

A taxpayer who incurs child or dependent care expenses in order to work is entitled to a nonrefundable income tax credit equal to a stated percentage of those employment-related expenses. Such expenses must relate to the maintenance of a household for children under 15 or other qualifying individuals. Generally, the credit is not available to the extent such employment-related expenses exceed the earned income of the taxpayer, or for a married couple, the earned income of the lower-earning spouse; thus, if one spouse is not working, no credit generally is allowed. Married couples generally must file a joint return to claim the credit.

The maximum amount of employment-related expenses eligible for the credit is $2,400 for one qualifying individual, and $4,800 for two or more qualifying individuals. The amount of the credit is reduced as the adjusted gross income of the taxpayer rises. The credit equals 30 percent of qualified expenses for taxpayers with AGI of $10,000 or less, and decreases (by one percentage point per $2,000 of AGI) to 20 percent of qualified expenses for taxpayers with AGI over $28,000.

Although thought of in part as a credit to assist low-income persons, few such individuals use the credit. It is estimated that in 1983, only one percent of married couples who claimed the earned income credit also claimed the child care credit. This result probably occurs because married couples with income low enough to be eligible for the earned income credit are predominantly one-earner couples, who are not eligible for the child care credit. Even among working unmarried low-income persons with children, however, use of the child care credit is low; fewer than six percent of unmarried heads of households who claimed the earned income credit also claimed the child care credit.

Provisions for the elderly

Present law includes several provisions of particular benefit to low-income elderly individuals—a nonrefundable income tax credit for the elderly and disabled, an extra personal exemption for taxpayers age 65 or over, and tax exemption of social security benefits for taxpayers with income below $32,000 ($25,000 for unmarried taxpayers).

The credit for the elderly and disabled is computed as 15 percent of a defined base amount. This defined base amount is currently computed from an initial base amount of $5,000 for a single person over age 65 or for a married couple filing jointly where only one

spouse is over age 65. If both spouses are over age 65, the amount is $7,500 if they file a joint return, and $3,750 if they file separate returns. These initial figures are reduced by the amount of certain nontaxable income of the taxpayer, such as social security benefits, and by one-half of the taxpayer's adjusted gross income in excess of $7,500 for single taxpayers, $10,000 for married taxpayers filing jointly, or $5,000 for married taxpayers filing separately. For disabled individuals, the defined base amount is limited to the amount of their disability income if it is less than their initial base amount.

As a result of these provisions, the tax threshold for elderly individuals is well above the poverty line under present law. For a single elderly taxpayer none of whose income consists of tax-free social security benefits, the tax threshold in 1986 is estimated to be $9,383, and for an elderly couple, the threshold is estimated to be $14,450. These are well above the estimated poverty levels for such an individual of $5,450 and $6,860, respectively.

Table 3.—Federal Income Tax Provisions Affecting Tax Threshold, 1948–1985

Year	Personal exemption	Minimum standard deduction (zero bracket amount) for joint returns	Earned income tax credit	General tax credit
1948–64	$600	10% of AGI	NA	NA.
1964–69	600	$200 plus $100 per exemption.	NA	NA.
1970	625	1,100	NA	NA.
1971	675	1,050	NA	NA.
1972–74	750	1,300	NA	NA.
1975	750	1,900	$400, phased out between $4,000–8,000 of AGI.	$30 per exemption.
1976	750	2,100	Same as 1975	$35 per exemption.
1977–78	750	3,200	Same as 1975	$35 per exemption.
1979–84	1,000	3,400	$500, phased out between $6,000–10,000 of AGI.	NA.
1985 and after (present law).	$1,000 adjusted for inflation ($1,040 for 1985).	$3,400 adjusted for inflation ($3,540 for 1985).	$550, phased out between $6,500–11,000 of AGI.	NA.

NA—Not applicable in that year.
AGI—Adjusted gross income.

III. AMOUNT OF TAX PAID AT THE POVERTY LEVEL

Table 4 below shows the poverty level and income tax threshold for families of one to six persons for 1978 and 1982-1986 (as estimated under present law). The tax computations in the table reflect assumptions that all family income consists of wages or salaries, that families of two or more include a married couple (rather than an unmarried head of household with one or more dependents), that all family members are under age 65, and that families of three or more persons are eligible for the earned income credit.

In 1978, the income tax threshold was below the poverty level only for single persons, and the maximum income tax paid by a single person at the poverty level was only $16. For three -and four-person families at the poverty line, the earned income credit offset a substantial part of the payroll tax.

In 1983, by contrast, the income tax threshold was below the poverty level for all family sizes except for three-person families. For four-person families, $1,395 in income below the poverty level amount was subject to tax; the corresponding figure for six-person families was $3,911. In 1985, after the first year of indexing and the increase in the earned income credit provided in the Deficit Reduction Act of 1984, the income tax thresholds for four -and six-person families were $1,567 and $4,314 below the poverty line, respectively. For 1986, the growth in these gaps is estimated to accelerate, making them $1,929 and $4,807, respectively. Even with indexing, and the increase in the earned income credit, the gap between the poverty level and the tax threshold grows faster than the rate of inflation for these families, because a taxpayer at the tax threshold is still eligible for the earned income credit and is affected by the fact that the credit is not indexed.

Table 4 also shows the amount of income tax and payroll tax paid by a family having income (all of which is includible in gross income) equal to the poverty level. While many low-income individuals also receive cash transfer payments that are excluded from gross income and, therefore, are not subject to the tax burdens shown in Table 4, other low-income individuals must rely on their earnings and thus are subject to these tax burdens under present law. For example, in 1985 it is estimated that a four-person family whose income is at poverty level ($11,003) could pay as much as $375 in Federal income tax, and a six-person family as much as $585.

In 1975, the Congress had sought to eliminate some of this burden by the refundable earned income credit, but since then inflation has raised tax liabilities and the poverty level so that the credit—which does not apply to families with income above $11,000—does not give any benefit to a significant number of low-income families. The table also shows the combined income and payroll tax burden at the poverty level as a percent of income. For

1985 and 1986, the table indicates that this burden could be as high as 11 percent of income.

Table 4.—Poverty Level, Tax Threshold, and Federal Tax Amounts for Different Family Sizes With Earnings Equal to the Poverty Level, 1978–1986 [1]

	Number of persons in family					
	1	2	3	4	5	6
Poverty level:						
1978	$3,311	$4,249	$5,201	$6,662	$7,880	$8,891
1982	4,900	6,280	7,690	9,860	11,680	13,210
1983	5,061	6,483	7,938	10,178	12,049	13,630
1984	5,277	6,759	8,276	10,612	12,562	14,211
1985	5,471	7,009	8,582	11,003	13,026	14,735
1986	5,719	7,326	8,971	11,502	13,617	15,403
Income tax threshold:						
1978	3,200	5,200	6,930	7,520	8,183	9,167
1982	3,300	5,400	8,237	8,727	9,216	9,706
1983–84	3,300	5,400	8,315	8,783	9,251	9,719
1985	3,430	5,620	8,943	9,436	9,929	10,421
1986	3,560	5,830	9,062	9,573	10,085	10,596
Income tax at poverty level:						
1978	16	0	−280	−134	−12	0
1982	202	106	−134	285	417	491
1983	207	119	−89	319	432	509
1984	226	149	−9	364	478	569
1985	233	153	−84	375	493	585
1986	246	165	−21	398	523	622
Payroll tax at poverty level:						
1978	200	257	315	403	477	538
1982	328	421	515	661	783	885
1983	339	435	532	682	808	913
1984	354	453	555	711	842	953
1985	386	494	605	76	918	1,039
1986	409	524	641	822	974	1,101
Combined income and payroll taxes at poverty level:						
1978	216	257	35	269	465	538
1982	530	527	381	946	1,200	1,376
1983	546	554	443	1,001	1,240	1,422
1984	580	602	546	1,075	1,320	1,521
1985	619	647	521	1,150	1,410	1,622
1986	655	689	620	1,221	1,497	1,723

Table 4.—Poverty Level, Tax Threshold, and Federal Tax Amounts for Different Family Sizes With Earnings Equal to the Poverty Level, 1978–1986 [1]—Continued

	Number of persons in family					
	1	2	3	4	5	6
Combined taxes as percent of income at poverty level:						
1978	6.5	6.0	0.7	4.0	5.9	6.1
1982	10.8	8.4	5.0	9.6	10.3	10.4
1983	10.8	8.6	5.6	9.8	10.3	10.4
1984	11.0	8.9	6.5	10.1	10.5	10.7
1985	11.3	9.2	6.1	10.5	10.8	11.1
1986	11.5	9.4	6.9	10.6	11.0	11.2

[1] Estimated for 1984, 1985, and 1986 (under present law). The tax computations in the table reflect assumptions that all family income consists of wages or salaries, that families of two or more include a married couple (rather than an unmarried head of household with one or more dependents), that all family members are under age 65, and that families of three or more persons are eligible for the earned income credit.

NOTE.—Negative figures in table reflect refundability of earned income credit.

Table 5 below illustrates the effect of filing status on the treatment of low-income individuals by the tax system. For a family size of two, as shown in the first two columns of the table, low-income unmarried heads of household with one dependent are treated more generously than married couples with no dependents. This result occurs because families with children are eligible for the earned income credit, while childless families are not.

The last two columns of Table 5 compare two different types of families of four with children—an unmarried head of household with three children and a married couple with two children. In this case, the unmarried taxpayer pays a higher tax at any given income level, although the difference is less than 1.5 percent of income for a family at the poverty level. In effect, the different treatment of the two types of families gives more relief when a larger number of adults is present in the family. Regardless of these differences, however, the table shows that the basic trends over the 1978 to 1986 period, described above in connection with Table 4, are similar regardless of filing status.

Table 5.—Tax Threshold and Federal Tax Amounts by Filing Status and Family Size, for Families with Earnings Equal to the Poverty Level, 1978–1986 [1]

	Family size			
	2 unmarried head of household	2 married couple	4 unmarried head of household	4 married couple
Income tax threshold:				
1978	$5,700	$5,200	$6,892	$7,520
1982	7,150	5,400	8,188	8,727
1983	7,293	5,400	8,269	8,783
1984	7,293	5,400	8,269	8,783
1985	7,859	5,620	8,891	9,436
1986	7,945	5,820	9,010	9,573
Income tax at poverty level:				
1978	−368	0	−60	−134
1982	−227	106	439	285
1983	−197	119	462	319
1984	−127	149	499	364
1985	−206	153	513	375
1986	−150	165	545	398
Payroll tax at poverty level:				
1978	257	257	403	403
1982	421	421	661	661
1983	435	435	682	682
1984	453	453	711	711
1985	494	494	776	776
1986	524	524	822	822
Combined income and payroll taxes at poverty level:				
1978	−111	257	343	269
1982	194	527	1,100	946
1983	236	554	1,144	1,001
1984	326	602	1,210	1,075
1985	288	647	1,289	1,151
1986	374	689	1,367	1,220
Combined taxes as percent of income at poverty level:				
1978	−2.6	6.1	5.1	4.0
1982	3.1	8.4	11.2	9.6
1983	3.6	8.5	11.2	9.8
1984	4.8	8.9	11.4	10.1
1985	4.1	9.2	11.7	10.5
1986	5.1	9.4	11.9	10.6

[1] Estimated for 1984, 1985 and 1986 (under present law). The tax computations in the table reflect assumptions that all family income consists of wages or salaries, that all family members are under age 65, and that families with children are eligible for the earned income credit.

NOTE.—Negative figures in the table reflect refundability of earned income credit.

IV. ISSUES IN REDUCING TAX BURDENS ON LOW-INCOME INDIVIDUALS

In terms of aggregate revenue loss per dollar of benefit to low-income taxpayers, the two most cost-effective tools to reduce tax burdens would be increases in the earned income credit and the zero bracket amount.

Earned income tax credit

Under present law, the earned income credit is phased out for income above $11,000. Therefore, unless the phaseout level is raised, the benefits from increasing the credit would be limited to individuals with income below the phaseout. Because the credit is not available to single persons or married couples without children, any increase in the credit would not raise the tax entry point for these taxpayers.

Also, the amount of the credit does not rise as the number of dependents increases; therefore, as presently structured, the credit does not serve to raise the tax entry point for very large families. There have been suggestions by some to vary the earned income credit by family size. This approach has been criticized by others who argue that such modifications would make the credit more of a welfare-type program and less of a way of alleviating the burden of the payroll tax on low-income individuals and less of a way of providing work incentives for low-income earners. In addition, such a proposal would present significant technical problems with respect to single parents who are maintaining a household.

Zero bracket amount (standard deduction)

Increasing the zero bracket amount also would be a relatively cost-effective way of providing tax relief to low-income individuals, because the tax reduction does not benefit taxpayers who itemize their deductions (since total itemized deductions are reduced by the ZBA before being subtracted from adjusted gross income). However, since married couples receive the same ZBA regardless of their family size, raising the ZBA does not serve to provide relatively greater relief to large families. On the other hand, consideration could be given to varying the ZBA by family size. In any case, sizable increases in the ZBA would be needed to raise the income tax thresholds of single persons and married couples up to the poverty level.

Another issue is the appropriate ZBA for heads of household. Although the personal exemption amount is uniform for all taxpayers, the ZBA varies according to filing status. Some argue that those unmarried individuals maintaining a household for dependents should be entitled to a higher ZBA than other unmarried individuals, on the ground that households with dependents may have extra costs not taken into account in the personal exemptions al-

lowed for dependents. Others argue, however, that such a proposal would be unfair by creating a marriage tax penalty under which two unmarried individuals, each with children, would pay a substantially lower income tax than a married couple with the same number of children and the same combined income.

Personal exemption

Substantial increases in the personal exemption would be necessary to raise the tax threshold for large families up to the poverty level. The difference between the poverty levels for four- and five-person families is more than $2,000, and it is more than $1,700 between five -and six-person families. Therefore, a personal exemption of around $1,800 would be needed to provide the difference in tax entry points between four-, five-, and six-person families that would correspond to the respective poverty levels for such families.

Combined tax changes

It would be possible to enact one or a combination of these increases in the earned income credit, ZBA, and personal exemption.

V. PROPOSALS TO ALLEVIATE INCOME TAX BURDENS ON LOW-INCOME INDIVIDUALS

A. Administration Tax Reform Proposal

Overview.—The President's Tax Proposals to the Congress for Fairness, Growth, and Simplicity (May 1985) would modify the zero bracket amount (ZBA), the amount and number of personal exemptions, and the earned income credit. The net effect of these changes would be to exempt families (and single persons age 65 or over) below the poverty level from Federal income tax. The changes also would reduce the number of single taxpayers (below age 65) below the poverty level who pay Federal income tax. The proposed rate reductions could decrease tax liabilities for low-income taxpayers above the poverty level. Many other provisions of the proposal also could affect some low-income individuals, including provisions affecting itemized deductions and the partial taxation of employer-provided health insurance.

Zero bracket amount.—Under the Administration proposal, the ZBA would be increased from $2,390 to $2,900 for single taxpayers, from $2,390 to $3,600 for head of household returns, and from $3,540 to $4,000 for married individuals filing joint returns (from $1,770 to $2,000 for married individuals filing separately). These increases in the ZBA would be effective in 1986; the ZBA would continue to be indexed for inflation in future years under the Administration proposal, as under present law.

Personal exemption.—The Administration proposal would increase the personal exemption ($1,040 for 1985) to $2,000 per exemption, effective in 1986, and would continue to index the exemption amount to inflation in future years. Also, under the Administration proposal, the additional personal exemptions for the elderly and blind would be repealed in favor of an expanded credit for the elderly and disabled (described below).

Earned income credit.—The Administration proposal would increase the amount of the earned income tax credit to a maximum of $700 (i.e., 14 percent of the first $5,000 of earned income). This larger credit would be reduced by 10 percent of the excess of adjusted gross income (or earned income, if greater) over $6,500. Thus, the credit would not be totally eliminated until AGI or earned income reaches $13,500. Also, under the Administration proposal the maximum earned income credit and the income limitation would be adjusted annually, beginning in 1986, for inflation; e.g., the maximum of $700 would be adjusted for 1986 to reflect 1985 inflation. This adjustment would be tied to the consumer price index percentage increase for the previous fiscal year.

Provisions for the elderly.—Under the Administration proposal, the extra personal exemption for the elderly would be repealed, but almost all of the effect of this change would be offset by the pro-

posed increase in the basic taxpayer exemption to $2,000. The proposal would not change the taxation of social security benefits.

Under the Administration proposal, an expanded tax credit for the elderly and disabled would be calculated in the same manner as current law with three changes. The proposal would increase the initial base amount to $7,000 for single individuals who are at least age 65 or blind or for married couples filing jointly where only one spouse is 65 or blind. The initial base amount for heads of households who are either age 65 or blind would be $8,750. Where both spouses are either over age 65 or blind, the initial base amount would be $11,500 if they file jointly or $5,750 each if they file separate returns. Also, the AGI phaseout level of the credit would be increased to $11,000 for single taxpayers, $12,500 for heads of households, $14,000 for married couples filing jointly, and $7,000 for married couples filing separately. As under current law, the initial base amount of the credit calculation would be reduced by one-half of the taxpayer's income in excess of these amounts. The third major change under the Administration proposal would be to index the credit for inflation in future years.

Child care credit.—The current credit for child and dependent care expenses necessary for gainful employment would be converted under the Administration proposal to an above-the-line deduction. Eligible expenses for the new deduction, like the current child care credit, would be limited to $2,400 for the expenses of one qualified individual and $4,800 for the expenses of two or more qualified individuals. Also, like the present law credit, the deduction would be limited by the amount of the taxpayer's earned income, or in the case of a married couple, by the earned income of the spouse with lower earnings.

B. Congressional Tax Reform Proposals

The following is a brief summary of provisions, contained in Senate bills introduced to date in the 99th Congress, that would alleviate Federal income tax burdens on low-income individuals by, for example, increasing the personal exemption or the zero bracket amount.

S. 321 (Senators DeConcini and Symms)

This bill would eliminate all tax credits and deductions while imposing a single tax rate of 19 percent. There would be a personal allowance of $4,500 for single returns, $8,000 for heads of households, and $9,000 for joint returns, plus $1,800 for each dependent; these amounts would be indexed for inflation in future years. The effective date of this legislation would be January 1, 1986.

S. 409 (Senator Bradley and others)

This bill (the "Fair Tax Act of 1985") would make several changes in the taxation of low-income individuals, effective January 1, 1987, in addition to making changes in tax rates and repealing various exclusions, deductions, and credits.

In lieu of a zero bracket amount, a standard deduction would be allowed to nonitemizers, equal to $6,000 for a joint return or $3,000 for single returns or a married individual filing a separate return.

The bill would not index these amounts, the personal exemption, or the rate brackets for inflation.

The size of the personal exemption would be increased to $1,600 for the taxpayer and for the taxpayer's spouse. The exemption for a head of a household would be increased to $1,800.

The bill would not modify the earned income credit. However, it would amend the child care credit by converting the credit to a deduction. The same restrictions as apply to the credit amount under present law also would apply to the deduction under the bill. The credit for the elderly or disabled would be repealed.

S. 411 (Senator Roth)

This bill (the "Broad-Based Enhanced Savings Tax Act of 1985"), in addition to changing tax rates, would change the zero bracket amount to $2,400 for unmarried individuals and heads of households and to $3,550 for married couples filing joint returns ($1,775 for separate returns). The personal exemption amount would be $1,050 in 1985. The ZBA and the personal exemption amount would be indexed for inflation in future years. Also, this bill would increase the maximum earned income credit to $676, increase the phaseout point of the credit, and index the credit for inflation in future years. The child care credit and the credit for the elderly or disabled would be repealed. The bill would be effective January 1, 1985.

S. 556 (Senator Chafee)

This bill (the "Base-Broadening Tax Act of 1985") generally would disallow 15 percent of itemized deductions, credits, and exemptions provided by current law, including the child care credit. However, there would be no reduction in the present-law credit for the elderly or disabled and the earned income credit. Neither the tax rates nor zero bracket amounts would be changed. The bill would be effective for tax years beginning on January 1, 1986, through December 31, 1989.

S. 888 (Senator Durenberger)

This bill (the "Economic Equity Act of 1985") would make changes to several tax provisions affecting low-income individuals. The zero bracket amount for heads of households would be increased to the amount of the zero bracket amount for joint returns. The bill also would increase the maximum amount of the child care credit from $1,440 to $2,400 and would make the credit refundable. In addition, the bill would make displaced homemakers one of the targeted groups under the targeted jobs tax credit. The effective date of the bill would be January 1, 1984.

S. 909 (Senator Quayle)

This bill (the "SELF-Tax Plan Act of 1985") would increase the zero bracket amount to $6,000 for unmarried individuals and heads of households, and to $10,000 for married individuals filing jointly ($5,000 if filing separately). The bill also would reduce the current 14 rate brackets to three brackets. Also, the earned income credit, the credit for the elderly or disabled, and the child care credit

would be repealed. The effective date of the bill would be January 1, 1986.

S. 1006 (Senators Kasten and Wallop)

This bill (the "Fair and Simple Tax Act of 1985"), in addition to changing tax rates, would increase the zero bracket amount to $3,300 for a joint return ($1,650 for a married person filing separately), $3,200 for a head of household return, and $2,600 for an unmarried individual. The amount of the personal exemption would be doubled to $2,000. These provisions would continue to be indexed for inflation in future years. The effective date of the bill would be January 1, 1986.

The amount of the earned income credit would be changed from the current maximum of 11 percent of the first $5,000 of earned income. Under the bill, a percentage equal to the combined employer/employee social security payroll taxes would be applied to a base amount ($4,500 for a family of two, $5,000 for a family of three, and $5,500 for a family of four or more) to yield the earned income credit. This bill also would provide for a new phaseout of the credit at a rate of 15 percent of adjusted gross income (or, earned income, if greater) as exceeds the base amount. The credit for the elderly or disabled and the child care credit would be repealed.

S. 1194 (Senator Moynihan)

This bill (the "Family Economic Security Act of 1985") would increase the maximum earned income credit from $550 to $800 for 1986. The credit would be phased out at a rate of 16 percent for incomes between $11,000 and $16,000. Starting in 1987, the maximum credit and the phaseout thresholds would be indexed for inflation. Also, the bill would increase the zero bracket amount for heads of households to that of married couples filing jointly.

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